Implementing A New Solvency Regime: The Mexican Experience

MANUEL AGUILERA-VERDUZCO
PRESIDENT OF THE INSURANCE AND SURETY NATIONAL COMMISSION (CNSF-MEXICO)

3RD CONFERENCE ON GLOBAL INSURANCE SUPERVISION
FRANKFURT AM MAIN, GERMANY, SEPTEMBER 9, 2014
Contents

1. THE MEXICAN INSURANCE SECTOR
   A BRIEF OVERVIEW

2. THE NEW SOLVENCY REGIME
   IMPLEMENTATION PROCESS

3. CLOSING REMARKS
   FINAL COMMENTS
INSURANCE MARKET SIZE: DIRECT PREMIUM, 2000-2013

SOURCE: CNSF
INSURANCE UNDERTAKINGS, 2000-2013

103 INSURANCE UNDERTAKINGS IN 2013

- 45 MEXICAN OWNED INSURERS
  - 40% MARKET SHARE

- 58 FOREIGN SUBSIDIARIES
  - 60% MARKET SHARE

SOURCE: CNSF
INSURANCE UNDERTAKINGS BY SIZE, 2013

INSURERS BY CAPITAL (IN USD MILLION)

- C < 10: 32
- 10 ≥ C < 25: 21
- 25 ≥ C < 100: 22
- 100 ≥ C < 500: 20
- C ≥ 500: 5

AVERAGE CAPITAL BY INSURER: 104 MILLION USD

CAPITAL CONCENTRATION

- TOP-5: 44.4%
- TOP-10: 62.9%
- TOP-20: 80.4%

SOURCE: CNSF
MARKET PORTFOLIO, 2013

DIRECT PREMIUM

15%  
19%  
19%  
47%

NUMBER OF POLICIES

135.7 million insurance policies in 2013

58.5

59.5

9.6

8.1

LIFE & ANNUITIES

AUTOMOBILE

PROPERTY & CASUALTY (W/O AUTO)

ACCIDENTS & HEALTH

SOURCE: CNSF
MARKET CONCENTRATION (HHI), 2005-2013

HERFINDAHL INDEX (HHI)

MODERATE CONCENTRATION

SOURCE: CNSF
MARKET GROWTH: PENETRATION INDEX, 2005-2013

PENETRATION INDEX
MODERATE GDP GROWTH (3%)
DYNAMIC GDP GROWTH (5%)
INERTIAL GDP GROWTH (1.9%)

SOURCE: CNSF
Contents

1. THE MEXICAN INSURANCE SECTOR
   A BRIEF OVERVIEW

2. THE NEW SOLVENCY REGIME
   IMPLEMENTATION PROCESS

3. CLOSING REMARKS
   FINAL COMMENTS
# New Mexican Insurance Law - Solvency II Type

**Process Started in 2007**

**In Force: April, 2015**

## Pilar I: Quantitative Elements
- Technical provisions based on BEL methods and risk margin concept.
- Standard model and internal models for the capital requirements calculation.
- Risk aggregation and mitigation.
- Own funds to cover solvency capital requirement.
- Economic balance sheet.

## Pilar 2: Revision and Control
- Strengthening of corporate governance practices.
- Own Risk and Solvency Assessment (ORSA).
- Supervisory review process: strengthening of CNSF’s risk based supervision.

## Pilar 3: Market Discipline
- Regulatory reporting.
- Transparency and public disclosure as a mechanism to enhance market discipline.
<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Solvency I</th>
<th>Mexico: Current Solvency</th>
<th>Mexico: New Solvency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuation</td>
<td>STATUTORY</td>
<td>MARKET CONSISTENT</td>
<td>MARKET CONSISTENT</td>
</tr>
<tr>
<td>Underwriting Risk</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Financial Risk</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>ALM Risk</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Operating Risk</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Risk Modeling</td>
<td>NO</td>
<td>RISK FACTORS</td>
<td>STOCHASTIC MODELS</td>
</tr>
<tr>
<td>Risk Aggregation</td>
<td>NO</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Risk Measure</td>
<td>NO</td>
<td>≃ VaR (99.5%)</td>
<td>YES</td>
</tr>
<tr>
<td>Stress Testing</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Technical Provisions</td>
<td>UNEARNED PREMIUM</td>
<td>SUFFICIENCY METHODS</td>
<td>BEL + RISK MARGIN</td>
</tr>
<tr>
<td>Investments</td>
<td>QUANTITATIVE LIMITS</td>
<td>QUANTITATIVE LIMITS</td>
<td>INVESTMENT POLICY</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>NO</td>
<td>CREDIT RISK</td>
<td>CREDIT RISK</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Information Disclosure</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
</tbody>
</table>
SECONDARY REGULATION

- Secondary regulation derived from the new Insurance Law.
- It comprises all the regulatory measures that will be in force on April 4, 2015.
- A comprehensive consultation process was introduced.

QUALITATIVE IMPACT STUDIES (EIC)

- Gap analysis with respect to the corporate governance and disclosure requirements considered in the new Insurance Law.
- A total of 3 studies complemented the secondary regulation’s consultation process.

QUANTITATIVE IMPACT STUDIES (EIQ)

- Validation and calibration of the models used as part of the Standard Model for the SCR calculation.
- A total of 5 studies (3 already completed) complement the secondary regulation’s consultation process.
### Qualitative Impact Studies (EIC)

<table>
<thead>
<tr>
<th>Category</th>
<th>EIC-1</th>
<th>EIC-2</th>
<th>EIC-3</th>
<th>To Complete Full Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance</td>
<td>64.5%</td>
<td>67.5%</td>
<td>72.4%</td>
<td>6.8 months</td>
</tr>
<tr>
<td>Risk Management</td>
<td>58.5%</td>
<td>60.1%</td>
<td>62.0%</td>
<td>8.8 months</td>
</tr>
<tr>
<td>Internal Control</td>
<td>54.9%</td>
<td>56.5%</td>
<td>60.4%</td>
<td>7.0 months</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>63.1%</td>
<td>67.7%</td>
<td>71.8%</td>
<td>5.1 months</td>
</tr>
<tr>
<td>Actuarial Function</td>
<td>62.5%</td>
<td>65.5%</td>
<td>68.5%</td>
<td>7.0 months</td>
</tr>
<tr>
<td>Fit &amp; Proper</td>
<td>67.3%</td>
<td>71.9%</td>
<td>77.5%</td>
<td>6.0 months</td>
</tr>
<tr>
<td>Board Committees</td>
<td>46.9%</td>
<td>51.0%</td>
<td>57.6%</td>
<td>6.6 months</td>
</tr>
<tr>
<td>Outsourcing</td>
<td>55.7%</td>
<td>57.8%</td>
<td>62.8%</td>
<td>5.8 months</td>
</tr>
<tr>
<td>Information Disclosure</td>
<td>57.8%</td>
<td>60.5%</td>
<td>66.6%</td>
<td>6.6 months</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>57.8%</td>
<td>60.6%</td>
<td>64.9%</td>
<td>6.8 months</td>
</tr>
</tbody>
</table>

Source: CNSF, EIC-3
QUALITATIVE IMPACT STUDIES (EIC)

- 3 insurers (0.2% market share)
- 30 insurers (11.9% market share)
- 42 insurers (73.0% market share)
- 13 insurers (12.5% market share)
- 85.5% market share

**EIC-3 (Total)**
- Overall Progress: 64.9%
- Average Implementation Term: 6.8 months

**EIC-3 (Top-10)**
- Overall Progress: 72.4%
- Average Implementation Term: 6.0 months

Source: CNSF, EIC-3
Market consistent valuation of the different items considered in the balance sheet.

An appropriate asset-liability matching reduces possible volatility in the balance sheet.

It considers all the risks an insurer is exposed as part of its operation.

There is risk aggregation (underwriting and financial risks) in order to reflect the benefits from diversification, mitigation and compensation of risks.

Risk measure based on a VaR level of 99.5%.

A 0.5% default probability in a one year time horizon.
**QUANTITATIVE ELEMENTS**

- Choice of BEL method for calculation of technical provisions (or the use of the statutory/simplified method).
- Choice of the Standard Model or an internal model for the calculation of the solvency capital requirement (SCR).

**REVISION AND CONTROL**

- Non-prescriptive definition of the specific features of the corporate government system.
- Implementing measures focused on functions to be performed and not on the size of the organisational structures.
- Risk management system (RMS) based on the nature, scale and complexity of the insurer’s operations.

**MARKET DISCIPLINE**

- Regulatory reporting (RR) and transparency and public disclosure requirements (TPD), according to the nature, scale and complexity of the insurer’s operations.
INELASTIC
REQUIRED RMS, RR & TPD COMPONENTS
IMPLEMENTATION EFFORT

ELASTIC
RMS, RR & TPD SOPHISTICATION
REQUIRED RMS, RR & TPD COMPONENTS
RMS, RR & TPD IMPLEMENTATION EFFORT

NATURE, SCALE AND COMPLEXITY OF THE INSURER'S OPERATIONS

ELASTIC
INELASTIC
ELASTIC

SOURCE: EY-UK
A dynamic insurance market that is gaining momentum with the structural reforms of the Mexican economy.

A new solvency regime that will be the foundation for the sound and efficient long-term growth of the Mexican insurance industry.

A challenge to introduce an internationally-aligned solvency regime without creating unnecessary operating stress in the market place.
Implementing A New Solvency Regime: The Mexican Experience

MANUEL AGUILERA-VERDUZCO
PRESIDENT OF THE INSURANCE AND SURETY NATIONAL COMMISSION (CNSF-MEXICO)

3RD CONFERENCE ON GLOBAL INSURANCE SUPERVISION
FRANKFURT AM MAIN, GERMANY, SEPTEMBER 9, 2014